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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-331

CHARLES E. SALIK, DAVID SALIK, AND MAURICE M. RICE,
Petitioners

vs.

UNITED CALIFORNIA BANK,
Respondent

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Petitioners seek to have the Court apply either of two *new* limitations periods to claims arising in California under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78 ("1934 Act"). The two alternative questions presented are as follows:

1. Should the statute of limitations applicable to a claim arising in California and brought under Section 10(b) of the 1934 Act be changed from the three-year-from-discovery statute governing fraud actions found in Section 338(4) of the California Code of Civil Procedure to the period of limitations under the California Corporate Securities Act found in Section 25506 of the California Corporations Code, which is one-year-from-discovery or four years from the transaction in question, whichever is earlier?

2. Should the statute of limitations applicable to any claim brought under Section 10(b) of the 1934 Act, wherever it arises, be changed from the appro-

priate state statute to a judicially created period co-extensive with the limitations period found in certain provisions of the Securities Act of 1933, 15 U.S.C. § 77 ("1933 Act") and the 1934 Act?

STATEMENT OF THE CASE

I. Factual Background.

On May 15, 1969, respondent United California Bank ("UCB") purchased from petitioners (hereinafter individually and collectively referred to as "the Saliks") 40,000 Class A shares of the Salik Bank in Basel, A.G. (the "Salik Bank") located in Basel, Switzerland*. Concurrently with this purchase, and as a part of the transaction, UCB purchased another 3,005 Class B shares from a Norwegian brokerage house. These shares comprised a majority interest in the Salik Bank. (App. A, pp. (2)-(3).) Soon after this purchase, the name of the Salik Bank was changed to United California Bank in Basel, A.G. ("UCB-Basel"). Its day-to-day operations were left in the hands of Swiss officers who had managed the bank before UCB's acquisition.

Approximately fifteen months after this acquisition, in August of 1970, UCB discovered that UCB-Basel had incurred losses of more than $40,000,000, principally as a result of unauthorized trading in commodities by its Swiss management. UCB-Basel was insolvent and is now in the process of liquidation. UCB, to protect its own reputation and goodwill, has paid or obligated itself to pay more than $42,000,000 to those depositors and creditors of UCB-Basel whose claims are approved in

* The facts set forth in this section are summarized from the complaint, which of course must be taken as true for purposes of the Saliks' motion to dismiss and which is attached as Appendix A to this brief. The Saliks' statement, in contrast, does not summarize the complaint but is devoted largely to assertion of disputed facts which are neither alleged in the complaint nor relevant to consideration of the petition.

independently administered moratorium proceedings in Switzerland. (App. A, p. (9).)

The discovery of these losses in August, 1970 prompted an intensive investigation. That investigation disclosed that the Saliks had sold an insolvent bank to UCB, that representations and warranties made by the Saliks in connection with the sale of their stock were wholly inaccurate and untrue, and that the true condition of the bank had been concealed from UCB by intricate falsifications of its records, all as appears in some detail in the complaint. (App. A, pp. (3)-(4), (8)-(9).)

The litigation is brought pursuant to the provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and of Rule 10b-5, 17 C.F.R. 240.10(b)-5, promulgated by the Securities and Exchange Commission thereunder. (App. C to Petition, p. 8a.) UCB also seeks essentially the same recovery under a breach of warranty theory, invoking the pendent jurisdiction of the district court.

II. Proceedings Below.

The complaint in this action was filed on February 16, 1972, well within three years after UCB's discovery of its claim against the Saliks.* Thereafter, the Saliks brought a Motion to Dismiss on the ground that the statute of limitations applicable to Section 10(b) actions should be changed from the three-year-from-discovery provisions of Section 338(4) of the California Code of Civil Procedure, which had been previously held govern-

* UCB also contends that the action was filed within one year after discovery of its claim against the Saliks, but this becomes irrelevant if the Court of Appeals decision applying the three-year-from-discovery fraud statute is not disturbed. If the Saliks prevail in their contention that the one-year-from-discovery period is applicable, the time of discovery will become a disputed issue of fact to be decided at the trial.

ing in cases of this kind, to the statute of limitations found in either Section 25506 of the California Corporations Code or Section 29(b) of the 1934 Act. (App. C to Petition, pp. 9a-10a, 12a.)

On May 26, 1972, the District Court denied the Saliks' Motion to Dismiss. (App. B to Petition.) The District Court certified the question for interlocutory appeal to the Ninth Circuit Court of Appeals which in turn granted permission for such an appeal.

On May 29, 1973, the Court of Appeals affirmed the decision of the District Court, holding that it would adhere to prior decisions establishing that Section 10(b) cases arising in California are governed by the three-year-from-discovery statute of limitations applicable to California actions for fraud. (App. A to Petition.) This petition followed.

REASONS FOR DENYING WRIT

I. INTRODUCTION AND SUMMARY.

In following its prior decisions applying the three-year-from-discovery fraud statute to Section 10(b) cases arising in California, the Court of Appeals correctly relied upon the principle that the periods of limitation governing Section 10(b) cases should be predictable. Adherence to earlier decisions insures that a plaintiff with a meritorious claim who relies on those decisions will not suddenly find that his claim is extinguished by the unforeseen application of a shorter limitations period.

This underlying policy of predictability has dictated — and reconciles — the choice of statute of limitations applicable to Section 10(b) cases in each of the circuits in which the question has arisen. There is in fact no conflict in the circuits on this score.

Moreover, it is now conceded that there is no federal statute of limitations applicable to Section 10(b) claims. The suggestion that this Court should fashion some new period of limitations by analogy to other provisions of the federal securities law is contrary to precedent and should be rejected. As the Court of Appeals observed, the enactment of such a statute is a matter to be addressed to Congress.

Finally, this case is at an interlocutory stage and the statute of limitations issue which the Saliks would have this Court decide piecemeal is not necessarily dispositive of the case. On the contrary, the limitations issue arises as to only one of UCB's two claims. And a decision at this time favorable to the Saliks on the limitations issue will not dispose of even the one count to which it is relevant, for such a decision will require the trier of fact to decide the factual question whether UCB discovered its claim within one year of the filing of this action.

II. THE COURT OF APPEALS CORRECTLY DECIDED THIS CASE.

The Court of Appeals offered three reasons for refusing to depart from earlier decisions holding that Section 10(b) cases filed in California are governed for limitations purposes by the California three-year-from-discovery statute applicable to fraud cases: (1) to do otherwise would defeat the policy that the statute of limitations applicable to Section 10(b) claims should be predictable, (2) the broad remedial policy underlying Section 10(b) is best served by a longer period of limitations and (3) the alternative statute suggested by the Saliks could not be adopted as written without overriding federal policy.

The Saliks' petition does not discuss any one of these reasons and hence does not address the central issues which their interlocutory appeal raises.

A. The Policy of Reasonable Predictability.

The Court of Appeals recognized that in at least three prior decisions it had held that Section 10(b) actions arising in California are subject to the three-year-from-discovery limitation period applicable to fraud cases pursuant to Section 338(4) of the California Code of Civil Procedure. The Court then noted, quoting from its earlier decision in *Douglass v. Glenn E. Hinton Investments, Inc.*, 440 F.2d 912 (9th Cir. 1971), that "[a]ggrieved persons have come to rely on our prior holdings" and that as a matter of federal policy it was undesirable to change "the law governing the timeliness of federal claims to correspond with each change in the substantive elements of a claim under the local securities law." (App. to Petition, p. 3a.)

In reaching this conclusion, the Court of Appeals acted in light of the reality that every statute of limitations calls for the total extinguishment of existing rights upon the passage of a period of time which, by the nature of things, is more or less arbitrary. Because a failure to commence proceedings within the statutory period has such drastic consequences, it is important that the applicable statute and its period of limitations be predictable. Thus, the Court of Appeals reasoned, once the statute applicable to Section 10(b) claims has been selected by judicial decision, the courts should generally adhere to those decisions and avoid changes in the relevant statutory period, particularly if to do otherwise would shorten the period and cut off enforceable rights.

This principle of predictability is the cornerstone of the Court of Appeals decision in this and other relevant cases.

In *Turner v. Lundquist*, 377 F.2d 44 (9th Cir. 1967) the Ninth Circuit Court of Appeals first decided that Section 338(4), the California general fraud limitations

statute, was applicable to Section 10(b) actions brought in California. The Ninth Circuit reaffirmed the holding of *Turner* in *Sackett v. Beaman,* 399 F.2d 884 (9th Cir. 1968) and in *Hecht v. Harris, Upham & Co.,* 430 F.2d 1202 (9th Cir. 1970).

None of these cases considered the possible application of California Corporations Code Section 25506, which was not enacted until 1968. However, that application was expressly considered and rejected by the Northern District of California in *Smith v. Guaranty Service Corp.,* 51 F.R.D. 289 (1970), and a similar result was reached by the Ninth Circuit Court of Appeals in *Douglass v. Glenn E. Hinton Investments, Inc.,* 440 F.2d 912 (9th Cir. 1971), a case indistinguishable from this except that it arose in the State of Washington.

The issue in *Douglass,* as in this case, was whether the statute of limitations applicable to fraud actions or the one contained in Washington's recently enacted securities law was to govern Section 10(b) actions brought there. Prior to *Douglass,* the Ninth Circuit had, as in California, applied Washington's general fraud statute to Section 10(b) claims. *Fratt v. Robinson,* 203 F.2d 627 (9th Cir. 1953); *Errion v. Connell,* 236 F.2d 447 (9th Cir. 1956). The defendants in the *Douglass* case argued, as the Saliks argue here, that Section 10(b) more closely resembled the Washington securities law than common law fraud and that, accordingly, the limitations period contained in the securities law should be applied to Section 10(b) actions. As in this case, the Court of Appeals in *Douglass* accepted the fact that the newly enacted state securities law more closely resembled Section 10(b) than did the elements of common law fraud (see 440 F.2d at 915, n. 3), but nonetheless found that the objectives of federal policy could best be achieved by the consistent application of the general fraud limitations

period to Section 10(b) cases. Accordingly, the court refused to change the applicable statute or depart from its earlier decisions.

In this case, the Court of Appeals, by following *Douglass* and the earlier Ninth Circuit decisions it cites, has reaffirmed that once the period of limitations applicable to Section 10(b) cases is fixed by decisional law, the policy of predictability, or reasonable stability as the *Douglass* court called it, dictates that the same period should be applied in later cases despite the emergence of new state statutes in the securities field. Any other decision would have defeated the policy of predictability and placed UCB and plaintiffs similarly situated in other cases in the position of losing their rights by a sudden, *ex post facto* change in the applicable period of limitations.

B. A Period of Limitations At Least As Long As the One Applied in Fraud Cases.

In addition to advancing the policy of predictability, the Court of Appeals observed that its decision best served the broad remedial policies of the federal securities law by reaffirming a longer rather than a shorter statute of limitations. (App. A to Petition, p. 3a.) *Azalea Meats, Inc. v. Muscat,* 386 F.2d 5, 8 (5th Cir. 1967); *Richardson v. Salinas,* 336 F.Supp. 997, 1001 (N.D.Tex. 1972); *Weinberger v. New York Stock Exchange,* 335 F.Supp, 139, 145 (S.D.N.Y. 1971).

The period applicable to Section 10(b) cases should be at least as long as the period governing fraud cases under state law. This is so because Section 10(b) applies with equal force to securities frauds containing all of the elements of common law fraud. It would surely be inconsistent with the broad remedial policy of the federal

securities acts to penalize plaintiffs whose Section 10(b) claims are aggravated enough to constitute a classic fraud by requiring them to meet an earlier deadline in the federal court than would have to be met in state court on a similar claim.

C. Consistency With Federal Policy.

The Court of Appeals also noted correctly that adoption of Section 25506 of the California Corporations Code as the statute applicable to Section 10(b) cases would require the rewriting of that two-pronged statute in order to preserve the policy that Section 10(b) statutes run from discovery. *See, e.g. Douglass,* 440 F.2d at 916; *Janigan v. Taylor,* 344 F.2d 781, 784 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965). The California statute is one-year-from-discovery or four years from the event, whichever is earlier. Therefore, to preserve the federal policy that periods of limitation should run from discovery, the court would either have had

> (a) to apply the one-year-from-discovery prong, thus eliminating the four-year-from-transaction cutoff; or
>
> (b) to apply the four-year prong, but rewriting it to run from discovery, thereby nulifying the one-year-from-discovery provision. (App. A to Petition, pp. 3a-4a.)

The Court of Appeals decided not to manhandle Section 25506 by judicial decree and instead, for all of the foregoing reasons, reaffirmed application of the three-year-from-discovery fraud statute applied in earlier cases.

III. THERE IS NO CONFLICT BETWEEN THE DECISIONS OF THE NINTH CIRCUIT AND THOSE OF OTHER CIRCUITS.

A. The Test for Choice of a State Limitations Statute Applicable to a Federal Claim Is the Statute Which Best Effectuates Federal Policy.

In *International Union, UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696 (1966), this Court held that the selection of a state statute of limitations applicable to a federal claim must be made in light of the effect of that selection upon federal policy. 383 U.S. at 705-07. This principle, as applied to Section 10(b) cases, was said in *Charney v. Thomas*, 372 F.2d 97 (6th Cir. 1967), to require selection of the statute "which best effectuates the federal policy at issue." 372 F.2d at 100. This standard has been adopted by each of the Courts of Appeal — including the Ninth Circuit — among which the Saliks seek to find a conflict. *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123, 125 (7th Cir. 1972); *Vanderboom v. Sexton*, 422 F.2d 1233, 1237 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); *Douglass*, 440 F.2d at 915.

The Saliks strain to equate this principle of effectuating federal policy with the "resemblance test" and incorrectly imply an endorsement by this Court of that test. (Petition, p. 8). The fact is, however, that the "resemblance test" does not afford any assurance that the result reached will be consistent with federal policy. As we shall show, the "resemblance test" is essentially mechanical and, if applied to the circumstances of this case, would produce a result at odds with federal policy.

B. Considered in Light of the Underlying Principle of Predictability, There Is No Conflict of Decision Among the Circuits.

This Court has held that a "fundamental purpose" of the Securities Acts "was to substitute a philosophy of full

disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963). It would surely be inconsistent with that purpose and with the fair administration of justice to deprive a Section 10(b) plaintiff of his day in court by application of an unforeseen statute of limitations. Hence, as we have previously stated, it is desirable to apply the statute which is the most predictable.

When there has been no prior decision as to which state statute of limitations governs a federal claim, the application of a "resemblance test" advances the policy of predictability. It is the best available guide to the most predictable statute. In *Vanderboom* and *Parrent*, two of the cases on which the Saliks most heavily rely, there apparently was no pre-existing decisional law. In both cases, the courts resorted to a "resemblance test". In *Charney*, the other Court of Appeals case on which plaintiffs rely, the Court determined that there was no provision of the Michigan securities law similar to Section 10(b). It therefore applied the fraud statute of limitations and did not reach the question presented here and in the *Douglass*, *Vanderboom* and *Parrent* cases.

In contrast to *Vanderboom* and *Parrent*, there was in the Ninth Circuit an established body of law holding the California fraud statute of limitations applicable to Section 10(b) actions. Under these circumstances, there was no need when UCB's case reached the court to resort to a "resemblance test" in order to find the most predictable statute. Predictability could be achieved by adherence to prior decisions. Indeed, to change the applicable statute in pursuit of some mechanical test would defeat the policy of predictability.

The Seventh Circuit in *Parrent*, the Eighth Circuit in *Vanderboom* and the Ninth Circuit in *Douglass* and this case all sought the most predictable statute. The Seventh and Eighth Circuits had no earlier decisions to reaffirm so they used the resemblance test. The Ninth Circuit adhered to its earlier holdings. But the policy of predictability was served in each case. As this analysis shows, the so-called conflict among the circuits on which the Saliks base their petition is illusory.

IV. THE COURT SHOULD NOT UNDERTAKE JUDICIAL CREATION OF A NATIONWIDE STATUTE OF LIMITATIONS FOR SECTION 10(b) ACTIONS.

The Saliks do not suggest, as they did in the Court of Appeals, that any particular statute contained within the federal securities acts be held applicable to Section 10(b) actions. Indeed, the federal courts have unanimously held, as the Saliks apparently concede, that the securities acts contain no express statute of limitations applicable to Section 10(b) actions. *See, e.g., Janigan v. Taylor*, 344 F.2d 781, 783 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965); *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951). Rather the Saliks contend that this Court should judicially fashion a period of limitations by analogy to a statutory pattern found generally in the securities acts. This argument is not only new; it is also in conflict with the authorities.

It is settled that in the absence of an applicable federal statute of limitations, the federal courts will turn to the state law of limitations. In *International Union, UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696 (1966), the Court considered the statute of limitations for an action under Section 301 of the Labor Management Relations Act, 29 U.S.C. §185. The Act itself contained no limitations provision and the petitioner argued, as the Saliks argue

here, that the Court should "devise a uniform time limitation to close the statutory gap left by Congress". 383 U.S. at 701. The Court held that, while a uniform limitations provision might be a desirable statutory addition, the lack of uniformity within the statute of limitations context did not sufficiently undercut federal policy to justify judicial legislation. It confirmed the established principle that, absent a federal statutory provision, the time limits within which a complaint could be filed were to be determined as a matter of federal law by reference to the appropriate state statute of limitations. 383 U.S. at 702-05. *See also Chevron Oil Co. v. Huson,* 404 U.S. 97, 104 (1971); *Cope v. Anderson,* 331 U.S. 461, 463 (1947); *Holmberg v. Armbrecht,* 327 U.S. 392, 395 (1946); Rules of Decisions Act, 28 U.S.C. §1652.

As the Court of Appeals observed, any dissatisfaction with the lack of uniformity in the limitation of Section 10(b) actions should be addressed to Congress, not the courts. (App. A to Petition, p. 4a.)

V. THE PETITION SHOULD BE DENIED BECAUSE IT SEEKS REVIEW OF AN INTERLOCUTORY ORDER ADDRESSED TO AN ISSUE WHICH IS NOT DISPOSITIVE OF THE CASE.

This Court of course has the discretion to grant the requested writ of certiorari. But "except in extraordinary cases, the writ is not issued until final decree." *Hamilton-Brown Shoe Co. v. Wolf Brothers & Co.,* 240 U.S. 251, 258 (1916). *See also Cobbledick v. United States,* 309 U.S. 323 (1940). The basis of this rule is spelled out in *American Construction Co. v. Jacksonville etc. Ry. Co.,* 148 U.S. 372 (1893), where the petitioners were denied review by certiorari of the modification of an injunction:

> "There are much stronger reasons against the interposition of this court to review a decree made by the Circuit Court of Appeals on appeal from an interlocutory order, than in the case of a final decree. . . . Whether an interlocutory order may be separately reviewed by the appellate court in the progress of the suit, or only after and together with the final decree, is matter of procedure rather than of substantial right; and many orders made in the progress of a suit become quite unimportant by reason of the final result, or of intervening matters. Clearly, therefore, this court should not issue a writ of *certiorari* to review a decree of the Circuit Court of Appeals on appeal from an interlocutory order, unless it is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause."
> 148 U.S. at 384.

The wisdom of the Court's reluctance to grant certiorari where there is no final judgment is confirmed by the facts of this case, for even a holding adverse to UCB on the statute of limitations issue will not dispose of either UCB's Section 10(b) claim, or of the pendent breach of warranty claim.

There appears to be no dispute that UCB's breach of warranty claim, which is based upon the same facts as its Section 10(b) claim, is governed by Section 337 of the California Code of Civil Procedure, which imposes a limitation period of four years. There also appears to be no dispute that the complaint was filed well within that period. Hence, the issue raised by the present petition is not even addressed to one of the two claims upon which UCB is proceeding.

Morever, UCB's Section 10(b) claim would not be disposed of even if this Court were to decide that it was

governed by a one-year-from-discovery period of limitations. Such a ruling would simply require the trier of fact, if otherwise disposed to find a Section 10(b) violation, to decide when UCB's claim was "discovered." It was no doubt for these reasons that both the District Court and the Court of Appeals denied the Saliks' applications for a stay of all proceedings pending a disposition of their interlocutory appeal and in fact this case has gone forward in the trial court during the pendency of the appeal.

In sum, the present petition should be denied if for no other reason than it seeks interlocutory review of a single issue which is not dispositive of the case and which indeed may not influence the outcome at all.

CONCLUSION

For the foregoing reasons the petition for certiorari should be denied.

Respectfully submitted,

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APPENDIX A

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United States District Court

SOUTHERN DISTRICT OF CALIFORNIA

UNITED CALIFORNIA BANK, a California corporation, *Plaintiff*, *v.* CHARLES E. SALIK, DAVID SALIK and MAURICE M. RICE, *Defendants.*	CIVIL NO. 72-58-GT COMPLAINT FOR VIOLATION OF SECURITIES LAWS AND BREACH OF WARRANTY

Plaintiff alleges as follows:

FIRST CAUSE OF ACTION — Violation of Securities Laws

1. This is an action to recover damages for violation of Section 10b of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and of Rule 10(b)-5, 17 C.F.R. 240.10b5, promulgated by the Securities and Exchange Commission thereunder.

2. The jurisdiction of this Court is invoked under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C.

§78aa, and under 28 U.S.C. §1331. The matter in controversy, exclusive of interest and costs, exceeds $10,000.

3. Plaintiff United California Bank ("UCB") is a corporation organized and existing under the laws of the State of California with its principal office in Los Angeles, California.

4. UCB is informed and believes and therefore alleges that defendant Charles E. Salik is a resident of San Diego, California.

5. UCB is informed and believes and therefore alleges that defendant David Salik is a resident of San Antonio, Texas.

6. UCB is informed and believes and therefore alleges that defendant Maurice M. Rice is a resident of Santa Ana, California.

7. Defendants, and each of them, in making and in causing to be made untrue statements of material fact and in omitting to state material facts necessary to make statements made not misleading, all as hereinafter alleged, made use of means and instrumentalities of interstate commerce and of the mails.

8. On March 14, 1969, UCB and defendants entered into an Agreement (the "Agreement"), pursuant to which UCB purchased from defendants a total of 40,000 shares of the Class A stock of the Salik Bank in Basel, A.G. (the "Salik Bank"), a corporation organized and existing under the laws of Switzerland with its principal place of business in Basel, Switzerland. A copy of the Agreement is attached hereto as Exhibit A and is incorporated herein by reference. The purchase price paid by UCB for said shares was $4,850,000.

9. Concurrently with the Agreement, and in reliance thereon, UCB purchased from Gunnar Boehn & Co., a corporation, 3005 shares of the Class B stock of the Salik Bank for the amount of $941,570 (Agreement, §6.1(c)). The shares purchased from Gunnar Boehn & Co. and from defendants comprised a majority interest in the Salik Bank, and upon the closing of the transaction on May 15, 1969 (the "Closing"), UCB became the majority shareholder of the Salik Bank.

10. In carrying on negotiations with respect to the Agreement and in providing financial and other information with respect to the Salik Bank prior to the Closing, all as hereinafter alleged, Dr. Paul E. Erdman ("Erdman") Vice-Chairman and Chief Executive Officer of the Salik Bank, acted as an agent of defendants.

11. Defendants and Erdman made prior to the Closing, both orally and in writing, the following statements of material fact, representations and warranties, *inter alia*:

(a) that the Salik Bank was in good standing under the laws of Switzerland and that it had complied with all applicable laws and regulations in connection therewith (Agreement, §2.1);

(b) that to their best knowledge and belief the Statement of Condition at the close of business on December 31, 1968 (the "Statement of Condition" attached as Exhibit A to the Agreement) was complete and correct and was prepared in conformity with generally accepted Swiss accounting principles consistently applied and that it fairly represented the financial condition of the Salik Bank on said date (§ 2.2(a));

(c) that to their best knowledge and belief all liabilities and contingent liabilities of the Salik Bank as

of December 31, 1968 were set forth in the Statement of condition (§ 2.2(b));

(d) that from December 31, 1968 to the Closing, to their best knowledge and belief, the operations of the Salik Bank had been conducted in the usual and normal manner and that no material losses had been sustained and that the business and assets of the Salik Bank were in the same condition as disclosed in the Statement of Condition except for changes in the ordinary course of business not materially adverse to the Salik Bank (§ 2.2(c));

(e) that during the period from December 31, 1968 to the Closing, to their best knowledge and belief, no material adverse changes had occurred in the financial condition of the Salik Bank or in its assets or liabilities and that no event or condition had occurred, then existed or was threatened which did or reasonably might materially and adversely affect the properties, business, assets or prospects of the Salik Bank (§ 2.2 (d));

(f) that the shares of the capital stock of the Salik Bank were fully paid up (§ 2.5);

(g) that net earnings of the Salik Bank for the calendar year 1968 amounted to more than $1 million and that net earnings for the calendar year 1969 were expected to be $2 million;

(h) that the Salik Bank's commodity position for its own account was small, and was held primarily to facilitate customer trading.

12. The statements, representations and warranties, and each of them, made by defendants as set forth in Paragraph 11 were untrue and, in the light of the circumstances under which they were made, misleading,

all as hereinafter set forth with particularity in paragraphs 13 through 20 and 22. (The dollar amounts hereinafter set forth, excepting amounts paid by UCB to purchase shares of the Salik Bank, have been converted from Swiss francs, using a convertion ratio of 4.3 francs to the dollar.)

13. At all times material hereto, the Salik Bank had not complied with, and was not in good standing under, applicable Swiss banking laws in, *inter alia,* the following material respects:

(a) the financial and liquidity ratio statements of the Salik Bank published publicly and provided to the Swiss National Bank and to the Swiss Banking Commission were at all times material hereto false; in particular, said statements failed to reflect substantial losses incurred as of the date of the Agreement; and

(b) the Salik Bank had failed to maintain minimum reserve requirements and proper liquidity ratios.

14. The Statement of Condition was neither complete nor correct, was not prepared in conformity with generally accepted Swiss accounting principles consistently applied and did not fairly reflect the financial condition of the Salik Bank on December 31, 1968, in, *inter alia,* the following material respects:

(a) failure to reflect unrealized losses from the Salik Bank's trading in commodities for its own account in the amount of approximately $1.6 million;

(b) failure to record commodity losses actually incurred in calendar year 1968 until after the close of the calendar year in the amount of approximately $300,000;

(c) recording of the fictitious sale of at least 4,000 shares of Class B stock in the Salik Bank in the amount of at least $1.2 million during the period September, 1968, through December 31, 1968, which stock was not in fact sold and not in fact paid for;

(d) failure to reflect income and capital taxes in the amount of approximately $600,000 due and payable for 1968 and prior years;

(e) overstatement of assets by approximately $2.9 million. The Statement of Condition showed assets of approximately $47.3 million, while assets in fact were approximately $44.4 million; and

(f) failure to reflect manipulations of the books and records as more specifically set forth in paragraph 22.

15. Neither all liabilities nor all contingent liabilities of the Salik Bank as of December 31, 1968, were set forth in the Statement of Condition. The major such liabilities and contingent liabilities are set forth in paragraph 14 above.

16. The operations of the Salik Bank during the period December 31, 1968, to the Closing were not conducted in the usual and normal manner and in fact during that period material losses were sustained and the business and assets of the Salik Bank were not in the condition disclosed by the Statement of Condition in the following respects, *inter alia:*

(a) the Salik Bank increased but concealed speculation for its own account, primarily in the cocoa futures market, resulting in further losses;

(b) the Bank took over losses of its customers as of March 31, 1969, in the amount of approximately $1.2 million; and

(c) the Bank continued and increased the manipulation of its books and records, as more specifically alleged in paragraph 22.

17. During the period December 31, 1968, through the Closing, events had occurred which materially and adversely affected the business assets and prospects of the Salik Bank as set forth herein.

18. The shares of the capital stock of the Salik Bank were not fully paid up as of December 31, 1968, March 14, 1969 (date of the Agreement), or May 15, 1969 (the Closing). In September 1968 the Salik Bank issued and purported to sell 12,500 shares of Class B stock. At least 4,000 of said shares were not in fact sold or paid for until mid-1969 although the books of the Salik Bank had been falsified to show that they were sold and paid for prior to December 31, 1968.

19. Rather than net earnings of more than $1 million, the Salik Bank suffered losses of approximately $2.28 million during the calendar year 1968. Further material losses were incurred during the first three months of 1969.

20. The Salik Bank's commodity position for its own account was not small or related to customer trading. Rather it was very large. At March 31, 1969, the Salik Bank had taken but concealed an open commodity position for its own account in excess of $5 million.

21. In addition to said untrue statements, defendants omitted to state, *inter alia*, material facts as hereinabove set forth with respect to a) the extent and nature of the Salik Bank's trading for its own account in the commodities markets, and b) the true financial condition of the Salik Bank. The statement of such facts was nec-

esary to make not misleading such statements made by defendants as were true.

22. Subsequent to the execution of the Agreement, UCB, pursuant to the provisions of Section 5.1 of the Agreement, conducted a review of the books and records of the Salik Bank. This review did not disclose the true financial condition of the Salik Bank because Erdman and, on information and belief, defendants had caused the manipulation of the books and records in order to conceal the true condition of the Bank. Such concealment was accomplished, *inter alia*, by the following types of manipulation:

(a) concealment of losses by the booking of fictitious assets. On December 31, 1968, an account used for this purpose contained approximately $95,000 in fictitious assets; during the first three months of 1969, approximately $1.6 million in fictitious assets were entered in this account;

(b) delay in recording on the books large realized losses, primarily incurred by the Bank's trading for its own account in the commodities markets. Approximately $300,000 in losses realized in 1968 was recorded subsequent to December 31, 1968; approximately $630,000 in losses realized during the first quarter of 1969 was booked thereafter;

(c) failure to provide for or to disclose unrealized losses due to market declines in commodities and securities;

(d) unwarranted transferring of income between accounts in order to give the appearance of normalcy to the income statement. As of December 31, 1968, approximately $750,000 had been so transferred;

(e) use of various means to hide the fact that part of the share capital, ostensibly fully paid, had not

been fully paid for, as more particularly alleged in paragraph 18;

(f) presentation of purportedly complete listings of the Bank's own holdings in commodities and foreign exchange, which were in fact only a fraction of such holdings.

23. The statements, representations and warranties made and omitted to be made by defendants to UCB and hereinabove set forth in paragraphs 11 and 21, and the conduct of defendants in connection with the negotiation, execution, consummation, performance and closing of the Agreement constituted acts, practices and a course of business which operated as a fraud and deceit upon UCB.

24. Said statements, representations, warranties and omissions were material and relied upon by UCB in entering into and performing the Agreement. Without them, UCB would not have entered into the Agreement, nor would it have done so had it known the true facts as to the financial condition of the Salik Bank.

25. UCB did not discover that the statements, representations and warranties of defendants were untrue or misleading until after August 1970 when it commenced an investigation prompted by the discovery that UCB Basel had incurred losses of more than $40,000,000 principally as a result of unauthorized trading in commodities. UCB Basel is insolvent and in the process of liquidation. UCB, to protect its reputation and goodwill, has paid or obligated itself to pay more than $42,000,000 to the depositors and creditors of UCB Basel.

26. As a proximate result of the untrue statements of material fact and omissions to state material fact and fraud hereinabove alleged, UCB has lost its investment in the Salik Bank, including:

(a) $4,850,000 paid to defendants,

(b) $941,570 paid for an additional 3005 shares purchased concurrently with the execution of and in reliance on the Agreement,

and has been damaged in additional amounts according to proof.

SECOND CAUSE OF ACTION — Breach of Warranty

27. UCB realleges and incorporates herein by reference each and all of the allegations hereinabove set forth in paragraphs 1 through 26 of this complaint.

28. UCB invokes the pendant jurisdiction of this Court.

29. Defendants, and each of them, expressly warranted in writing the truth of the matters set forth in subparagraphs 11(a) through 11(f). Defendants, and each of them, expressly warranted orally the matters set forth in subparagraphs 11(g) and 11(a). Defendants breached each of the said express warranties in that the matters stated therein to be true were not true, all as hereinabove alleged.

30. UCB duly performed all the conditions of the Agreement with defendants to be performed on its part.

WHEREFORE, UCB prays as follows:

1. That it have judgment against defendants, and each of them, in the amount of $5,791,570, and in additional amounts according to proof, together with interest thereon at the rate of seven per cent per annum from May 15, 1969, until paid;

2. That it recover its reasonable attorneys' fees and costs of suit; and

3. That the Court grant such other and further relief as is just and proper.

DATED: February 15, 1972.

O'Melveny & Myers
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By _____
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